

# **INTRODUCTION TO COMPLIANCE ASSESSMENT**

## **BACKGROUND**

### **OVERVIEW**

On December 8, 1993, the U.S. Congress enacted Customs modernization provisions under Title VI of the North American Free Trade Agreement Implementation Act (Public Law 103-182). These provisions are commonly called the Customs Modernization Act (Mod Act). The Mod Act is based on two basic tenets, shared responsibility and informed compliance. Shared responsibility means that importers and Customs have a mutual responsibility to ensure compliance with trade and Customs laws. The purpose of informed compliance is to maximize voluntary compliance. The informed compliance concept imposed many publication, consultation and notice obligations on Customs.

The Mod Act fundamentally altered the relationship between importers and the Customs Service. The Act shifted the legal responsibility for declaring the value, classification and rate of duty applicable to entered merchandise to the importer and requires importers to use reasonable care to assure Customs is provided accurate and timely data. Customs retains the ultimate responsibility to "fix" the value, classification and rate of duty. Informed compliance is based on the premise that, in order to meet their responsibilities, importers need to be clearly and completely informed of their legal obligations. Under the Mod Act, Customs will spend more time and use more effective methods to inform the public with the goal to maximize voluntary compliance and reduce the number of instances where enforced compliance is necessary.

### **AUTHORITY TO CONDUCT AUDITS**

Under 19 U.S.C. 1509, Customs may examine records to ascertain the correctness and determine the importers' liability for duty, fees and taxes due the United States.

### **OBJECTIVES OF COMPLIANCE ASSESSMENTS**

Under the shared responsibility concept of the Mod Act, the primary focus of regulatory audit is to maximize future compliance. Regulatory audits will be performed by an interdisciplinary Compliance Assessment (CA) team including:

- Auditor in charge (CA) team leader)
- Auditors, including a computer audit specialist (CAS)
- International trade specialist (ITS)
- Import Specialist (IS)
- Account Manager (if one has been assigned)
- Other specialists as needed.

A CA is a type of importer audit performed by a Customs CA team which uses traditional audit techniques, including statistical testing, and will generally cover an importer's most recently completed calendar and fiscal year. A CA tests import and financial transactions to (1) assess the compliance level in each trade area applicable to the importer, (2) determine whether the importer has documented

Customs internal controls and (3) evaluate the risk to Customs of the importer's non-compliance. If the CA determines that compliance is at acceptable levels in all areas tested the audit process ends. An exit conference is held to discuss the results and the audit report is issued.

If compliance is unacceptable in any of the areas tested or Customs internal controls need to be documented, the CA team will work with the importer to determine the cause and effect, (including any loss of revenue) of the non-compliance. When compliance has been assessed, the exit conference is held to discuss results of the audit with the importer and then the audit report is issued.

If the importer needs to improve compliance or has not documented Customs internal controls, a follow up review will be conducted. After the importer has implemented corrective procedures, the account manager, if one has been assigned to the importer, with assistance from the audit team, will review the corrections, and perform necessary tests to determine if procedures were corrected and compliance is at an acceptable level.

By working with importers to improve their procedures and systems, compliance should improve, resulting in accurate revenue collection. Highly compliant companies will receive benefits such as fewer cargo examinations, less frequent audits and fewer reviews of entries by import specialists. If Customs carries out its responsibility properly and compliance does not improve, Customs will then pursue enforcement measures.

## **REGULATORY AUDIT PROCESS**

### **➤ Planning and Preparation for Audit**

When the actual work on the CA is scheduled to begin, the CA team leader will contact other members of the CA team.

To determine if there are any open investigations on the importer, the CA team leader must check with the international trade specialist at the appropriate Strategic Trade Center. If the Office of Investigations opens an investigation of the company and requests audit support of the investigation, the importer will be advised of audit's role in the investigation.

The importer was selected for the CA because of its volume of imports in one or more primary focus industries. The international trade specialist for that industry is a member of the CA team. Prior to the start of the CA, the international trade specialist, with input from the CA team, prepares an account profile, which provides background information on the importer, Customs data, industry trends and analysis. The international trade specialist and CA team leader should work together to assure the profile is relevant and useful to the CA team. The importer may request a copy of the profile of its importing activity under the Freedom of Information Act (FOIA).

The CA team should review the profile and obtain as much information as possible about the company from within Customs to determine specifically what Customs programs, commodities, and trade issues to review during the CA. The CA team should use the profile or other Customs data, to tailor the sample general and electronic data processing (EDP) questionnaires to better reflect the company's Customs activities. Responses to the modified questionnaires will provide the CA team with key information about the importer's Customs systems, procedures, and internal controls.

➤ Controlled Assessment Methodology (CAM)

A controlled assessment methodology is a joint effort on the part of an importer and Customs to review the company's import procedures, internal controls, and import transactions using statistical sampling. A controlled assessment methodology is conducted within the scope of a CA and is intended to expedite the CA process while offering an opportunity for the company to review its import transactions and to file prior disclosures if non-compliance is found. If the company elects to participate in a controlled assessment methodology, the CA team performs certain preliminary steps and selects statistical samples, but the importer reviews the supporting documentation prior to its review by the CA team. The controlled assessment methodology will be discussed with the importer at the advance conference.

➤ Advance Conference

Several months before the CA is to begin, the CA team should contact company officials to arrange a meeting to discuss the scheduled CA. The CA team leader should request representation by someone at the executive level of the company to ensure a high level of cooperation. At the advance conference, the compliance assessment team will go over the questionnaires, explain what is required, discuss time frames for the review, and request a company contact be assigned. The CA team will also ask the importer to assign a company expert on its electronic data processing system to work with the team computer audit specialist to determine efficient sampling frames for transaction testing. In addition to the questionnaires, the CA team will provide the other CAT Kit documents to the company.

➤ Engagement Letter

After the company's response to the questionnaires is received and reviewed, Regulatory Audit will send a letter confirming the date for the formal entrance conference and listing the types of records and documentation needed for the audit.

➤ Entrance Conference

Auditor(s), the import specialist(s), other Customs officials assigned to the CA team, and company officials attend the entrance conference to discuss the scope, objectives, and the estimated time required for the audit. At the entrance conference, company officials should be reminded that audit work could be completed more quickly if the company responds fully and promptly to questions and requests for information during the audit.

➤ Coordination with the Company

Through informal meetings, the auditor will advise the company of the results of the CA and keep company officials fully informed of any matters that will ultimately require correction or resolution, unless, criminal or fraudulent activity is discovered. If criminal or fraudulent activity is discovered, the auditor will notify the Office of Investigations who has authority to make decisions about whether to proceed with the audit.

In addition to criminal or fraudulent activity that is immediately referred to Office of Investigations, the CA team will refer to the Enforcement Evaluation Team (EET) those discrepancies/possible violations that reach the level where they have an impact on domestic industry, public health and safety, and/or protection of the revenue. The enforcement evaluation team consists of a multi-disciplined group selected from the service port and the Office of Investigations who meets regularly to determine the course of action on those discrepancies and possible violations that rise to the impact level discussed above. The

basic role of enforcement evaluation teams is to 1) make an early determination of the nature, extent and impact of instances of non-compliance 2) select the Customs response best suited to remedy the problem; and 3) follow-up on that action to ensure the non-compliance problem is solved. The CA team referrals are made to enforcement evaluation team at the completion of the review of each trade area when it is determined that findings meet the criteria for referral.

#### ➤ Work During the Compliance Assessment

During the CA, the auditors will become familiar with the company's operating procedures and internal controls concerning Customs matters. In addition to reviewing written procedures, records and documents such as contracts and purchase orders, the auditors will interview personnel responsible for various activities that affect information submitted to Customs. The auditors will also conduct tests to verify that operating procedures are documented and are providing accurate Customs entry data. Because of the volume of transactions expected, sampling techniques will be used to test the company's systems. The computer audit specialist will work with company representatives to devise tests using automated processes when possible.

If the assessment indicates compliance is at acceptable levels, an exit conference will be held with the company and a report will be issued.

When compliance levels are acceptable, but the importer has not documented the internal control procedures used for Customs transactions, the CA team will recommend the importer develop written procedures.

If compliance rates are not acceptable, the CA team will evaluate system deficiencies and provide guidance to the company during the development of corrective procedures. It may be advantageous for both the company and Customs to project the findings of the original sample to the sampled universe to quantify the effect of the non-compliance(s). If the company does not agree to project the results, the company will be asked to determine the extent of the problem and compute lost revenue. If the company fails to complete this action, the audit team will use all reasonable means to quantify the loss of revenue, including projecting of the results of the original sample and/or reviewing additional transactions.

When non-compliance is identified, the company, with the help of the audit team will develop a compliance improvement plan.

#### ➤ Prior Disclosures

Customs encourages importers to identify non-compliance with Customs laws and regulations and submit prior disclosures to Customs in accordance with 19 U.S.C. §1592. It is possible that some of the errors identified by the CA team during transaction testing have been discovered and reported to Customs on a prior disclosure. Regardless of when the prior disclosure is submitted, those transactions will be counted as errors in the computation of compliance rates just as other errors identified by the CA team. However, if the importer has implemented system improvements to prevent recurrence and these improvements have been tested by the CA team, then they will be considered when assessing the importer's compliance risk category.

➤ Exit Conference

After all trade areas have been evaluated for compliance, the auditor will arrange a formal meeting with the company to discuss the audit results.

➤ Reporting Results

The report will be completed within 90 days following the exit confidence unless Customs notifies the company being audited of the reason for the delay and the anticipated completion date. A copy of the report will be issued to the company within 30 days following completion of the report. If a formal investigation is initiated, the report may not be released to the company immediately.

➤ Follow Up

After the importer implements corrective procedures, Regulatory Audit will conduct a follow up review to test the company's compliance under the new procedures. The scope of the follow up will depend on the corrections needed, but additional transaction testing will usually be required to determine if the corrections improved compliance to an acceptable level.

<b>NOTE:</b>	<b>The CA team uses a Compliance Assessment Team (CAT) Kit to conduct CA's. The Kit contains the audit program, sampling plans and guidelines used by the CA team to assure that the importers' systems provide accurate and complete Customs entry data. Numbered exhibits with an index organize the Kit. The most recent CAT Kit can be found on the Customs Web-site at <a href="http://www.customs.ustras.gov">http://www.customs.ustras.gov</a>.</b>
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